CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

Revised September 26, 2005

H.R. 2830
Pension Protection Act of 2005

As ordered reported by the House Committee on Education and the Workforce on June 30, 2005

SUMMARY

H.R. 2830 would make changes to the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code (IRC) that would affect the operations of private pension plans. It would do so mostly by changing the funding requirements for tax-qualified, defined-benefit pension plans and the premiums paid to the Pension Benefit Guaranty Corporation (PBGC).

The budgetary effects of the bill would result from:

- Increased income to the PBGC from premiums paid by the sponsors of pension plans—totaling an estimated $5.1 billion over the next 10 years.

- A loss of federal income tax revenue, primarily because more rigorous funding rules would be imposed on plans' sponsors; the Joint Committee on Taxation (JCT) estimates that enacting H.R. 2830 would reduce federal revenues by $5.5 billion over the 2006-2015 period.

- Additional benefit payments—totaling an estimated $0.5 billion over 10 years—that the PBGC would have to make as a result of a number of changes made by the bill.

In combination, those effects would add $0.8 billion to federal budget deficits over the 2006-2015 period, CBO estimates. The additional premium income would have another effect: it would increase the balances in the PBGC's on-budget revolving fund and therefore forestall the need for significant transfers to that revolving fund from the PBGC's nonbudgetary trust fund in order pay insured benefits. Because those transfers are treated in the budget as offsetting collections (that is, offsets to outlays), smaller transfers would result in higher net outlays for PBGC's on-budget revolving fund. The improvement in the financial condition of that fund would eliminate the need for $5.7 billion in transfers to the fund from 2013

through 2015, CBO estimates, thereby increasing on-budget outlays by that amount. Adding that effect to the other impacts of the bill, CBO projects that enacting H.R. 2830 would increase federal budget deficits by $6.5 billion over the 2006-2015 period.

The bill would improve the budget outlook in the near term but would increase budget deficits in later years because of the way some of the provisions would phase in and because the reduction in transfers to the on-budget revolving fund would occur towards the end of the 10-year period. CBO estimates that enacting the bill would reduce federal deficits by $5.7 billion over the 2006-2008 period, but would add $12.3 billion to budget shortfalls from 2009 through 2015.

Major provisions of H.R. 2830 would:

- Require sponsors of single-employer pension plans to meet a funding target that is at least 100 percent of current liabilities;

- Specify that the discount rate used to calculate the present value of current pension liabilities be based on a segmented yield curve of corporate bonds rather than the interest rate on 30-year Treasury bonds;

- Restrict the use of credit balances to offset required pension contributions;

- Place limits on benefit accruals for participants in certain underfunded plans;

- Increase the limits on the tax-deductible contributions sponsors may make to plans;

- Increase the per-participant premium paid to the PBGC for single-employer plans;

- Change the funding rules for multiemployer pension plans;

- Enhance disclosure requirements for both single-employer and multiemployer pension plans; and

- Address the legal status of so-called hybrid defined-benefit pension plans.

Not all of these policies would directly affect federal spending or revenues.

Pursuant to section 407 of H. Con. Res. 95 (the Concurrent Resolution on the Budget, Fiscal Year 2006), CBO estimates that enacting H.R. 2830 would not cause an increase in direct spending greater than $5 billion in any of the 10-year periods between 2016 and 2055.

CBO has reviewed the nontax portions of H.R. 2830 and determined that they contain no intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would impose no costs on state, local, or tribal governments. Those provisions would impose a number of mandates on sponsors and administrators of single-employer and multiemployer private pension plans. CBO estimates that the direct cost of those private-sector mandates, less the direct savings from those mandates, would exceed the annual threshold specified in UMRA ($123 million in 2005, adjusted annually for inflation) in 2009 and subsequent years.

JCT has determined that the tax provisions of H.R. 2830 contain no intergovernmental or private-sector mandates as defined in UMRA.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of H.R. 2830 is shown in the following table. The costs of this legislation would fall within budget function 600 (income security).

BASIS OF ESTIMATE

H.R. 2830 contains changes to both ERISA and the Internal Revenue Code that would affect sponsors of defined-benefit pension plans. Under current law, the funding rules are exactly the same in both ERISA and IRC. In certain instances, however, changes made by the bill to the pension funding requirements of ERISA are inconsistent with changes made to the funding rules in the IRC. CBO's and JCT's budget estimates assume that, if H.R. 2830 is enacted, additional changes would be made to the IRC to make it consistent with those changes made to ERISA by H.R. 2830. Those estimates also assume that H.R. 2830 and the corresponding changes to the IRC will be enacted by December 2005.

	By Fiscal Year, in Millions of Dollars									
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
CHANGES IN DIRECT SPENDING										
Changes in Flat-Rate Premiums Paid to PBGC										
Estimated Budget Authority	-79	-158	-240	-314	-552	-586	-655	-690	-759	-828
Estimated Outlays	-79	-158	-240	-314	-552	-586	-655	-690	-759	-828
Changes in Variable Premiums Paid to PBGC										
Estimated Budget Authority	0	-25	-170	-246	-255	-191	-68	66	237	360
Estimated Outlays	0	-25	-170	-246	-255	-191	-68	66	237	360
Changes in Net Benefit Payments										
Estimated Budget Authority	-1	*	6	19	35	54	72	88	101	112
Estimated Outlays	-1	*	6	19	35	54	72	88	101	112
Subtotal										
Estimated Budget Authority	-80	-184	-404	-541	-771	-722	-651	-536	-421	-356
Estimated Outlays	-80	-184	-404	-541	-771	-722	-651	-536	-421	-356
Changes in Transfers from PBGC’s Nonbudgetary Trust Fund										
Estimated Budget Authority	0	0	0	0	0	0	0	1,068	3,092	1,572
Estimated Outlays	0	0	0	0	0	0	0	1,068	3,092	1,572
Total Changes in Direct Spending										
Estimated Budget Authority	-80	-184	-404	-541	-771	-722	-651	532	2,671	1,216
Estimated Outlays	-80	-184	-404	-541	-771	-722	-651	532	2,671	1,216
CHANGES IN REVENUES										
Changes to Funding Rules for Single-Employer Plans	778	2,584	1,761	-1,420	-2,502	-2,185	-1,757	-1,070	-758	-659
Changes to Funding Rules for Multiemployer Plans	*	-2	-8	-18	-28	-34	-40	-46	-52	-58
Changes to Benefit Accrual Standards	-24	-9	1	6	-3	-8	6	25	29	13
Total Changes in Revenue	754	2,573	1,754	-1,432	-2,533	-2,227	-1,791	-1,091	-781	-704
NET INCREASE OR DECREASE (-) IN BUDGET DEFICITS										
Net of Transfers from PBGC’s Nonbudgetary Trust Fund	-834	-2,757	-2,158	891	1,762	1,505	1,140	1,623	3,452	1,920
Excluding Transfers from PBGC’s Nonbudgetary Trust Fund	-834	-2,757	-2,158	891	1,762	1,505	1,140	555	360	348

SOURCES: Congressional Budget Office and Joint Committee on Taxation.

NOTES: PBGC = Pension Benefit Guaranty Corporation.
* = less than $500,000.

Direct Spending

Increase in Flat-Rate Premium. Under current law, sponsors of single-employer pension plans insured by the PBGC are required to pay the agency a premium of $19 per participant. H.R. 2830 would increase the flat-rate premium to $30 per participant in 2006 and index it to wage growth starting in 2007. However, no plans would pay the full increase immediately. The bill would phase in the rate increase differently depending on whether the ratio of a plan's assets to its liabilities (known as its funding ratio) is above or below 80 percent. For plans that have a funding ratio of 80 percent or higher, the increased rate would be phased in over a five-year period; for plans with a funding ratio of less than 80 percent, the rate increase would be phased in over a three-year period. Both phase-in periods would begin in 2006 and the premium rate for all single-employer plans would be the same—approximately $35 per participant—by 2010.

About 35 million people currently participate in tax-qualified, single-employer pension plans. This figure includes active workers, former workers who are vested but have not started collecting retirement benefits, and annuitants. The number of participants in single-employer plans insured by the PBGC has remained nearly constant for the past decade, and CBO assumes it would remain steady for the next 10 years.

The current premium of $19 per participant generates about $650 million in premium income annually for the PBGC. CBO estimates changes to the flat-rate premiums made by H.R. 2830 would increase receipts by $1.3 billion over the 2006-2010 period and $4.9 billion over the 2006-2015 period. The varying amounts of additional premiums from year to year reflect both the phase-in of the rate increase and the rounding of the new rates to the nearest dollar, as specified by the bill. Because the PBGC's premiums are recorded as offsetting collections to a mandatory spending account, increases in premium collections are reflected in the budget as decreases in direct spending.

Variable Premiums. Under current law, sponsors of single-employer plans with assets less than liabilities are generally required to pay a variable premium, which is based on the amount of underfunding in the plan. The variable premium rate is $9 per $1,000 of underfunding. The amount of income from this type of premium varies from year to year; in 2004 it generated approximately $800 million in receipts.

H.R. 2830 would affect how much the PBGC collects from variable premiums because it would change the way plans' sponsors calculate the amount of underfunding. Starting in 2006, current law will require plans to discount their current liabilities, in order to determine the amount of underfunding, using an interest rate that is the four-year moving average of the rate on 30-year Treasury bonds.[1] H.R. 2830 would allow plans to discount their pension obligations using a yield curve based on a three-year weighted average of yields on investment-grade corporate bonds. The yield curve, which would be determined by the Secretary of the Treasury, would be divided into three segments: yields for bonds maturing in the five-year period following the first day of each new plan-year; yields for bonds maturing during the next 15-year period; and yields for bonds maturing after the initial 20-year period. These segments would be used to discount benefit payments expected to be made by plans during each of the three periods.

When compared to interest rates on 30-year Treasury bonds, the segmented yield curve would generally result in lower discount rates for participants whose benefits will be paid in the near term, and higher discount rates for participants whose benefits will be paid in later years. Discount rates and the present value of pension liabilities have an inverse relationship: increasing the discount rate results in a lower valuation of liability, while lowering the discount rate produces a higher valuation of liability. Based on information provided by the PBGC, CBO estimates that the segmented yield curve would reduce the total present value of current liabilities among all underfunded plans by about 5 percent.

Reducing the present value of current liabilities would generally reduce future contributions that plans' sponsors would be required to make. Other changes to the funding rules (which are discussed in more detail later) would increase contributions. CBO estimates that, under H.R. 2830, firms initially would have to contribute less to their plans, but later would have to contribute more than under current law. The change in contributions would have significant effects on federal revenues, as discussed later in this estimate. The change in contribution patterns would also affect how many plans are underfunded and how much underfunding exists in those plans. This, in turn, would affect the PBGC's income from variable premiums.

H.R. 2830 would also have an effect on which plans are required to make a variable premium payment. Current law provides underfunded plans with ways to reduce or avoid variable premium payments. Plans that have reached a statutory "full funding limit" are exempt from paying a variable premium, even though they may be substantially underfunded. H.R. 2830 would eliminate the full funding limit exemption and would require all plans that are underfunded to pay the variable premium on any underfunding.

1. Public Law 108-218, the Pension Funding Equity Act, changed how current liabilities of covered plans are discounted during plan-years 2004 and 2005. During those two years, current liabilities are discounted using an interest rate on high-grade corporate bonds, as determined by the Department of the Treasury. Prior to those years, the discount rate was based on the interest rates on 30-year Treasury bonds.

CBO estimates that enacting H.R. 2830 would increase receipts from variable premiums by $696 million over the 2007-2010 period and by $292 million over the 2007-2015 period.[2] As with flat-rate premiums, increases in receipts from variable premiums are reflected as decreases in direct spending.

PBGC's Disbursements. H.R. 2830 would affect both how much sponsors are required to contribute to their plans and how much benefits may increase under certain plans insured by the PBGC. Such changes would affect the amount of unfunded liabilities that the PBGC assumes in the event that a pension plan is terminated (i.e., claims) and thus the payments the agency makes to beneficiaries in terminated plans. CBO estimates that the policies contained in H.R. 2830 would increase benefit outlays by $59 million over the 2006-2010 period and by $486 million over the 2006-2015 period.

Several of the changes to the pension funding rules would have countervailing effects on the contributions plans' sponsors would be required to make over the next 10 years. Basing the discount rate for calculating the present value of liabilities on corporate bonds instead of Treasuries would cause the present value of current liabilities among underfunded plans to shrink by more than $50 billion in 2006, CBO estimates. This policy would have the effect of reducing required contributions by plans' sponsors.

Other changes made by the bill would also have an effect on required contributions. Current funding rules require that sponsors of insured plans make contributions to cover the costs of benefits accrued in a given year and that contributions above that amount are required only if the actuarial value of a plan's assets is less than 90 percent of current liabilities. These additional payments (referred to as "deficit reduction contributions") can be amortized over periods ranging from three to 30 years, depending on how the underfunding occurred.[3] H.R. 2830 would require that, in addition to covering its normal costs, a sponsor must make additional contributions if assets are less than 100 percent of current liabilities (referred to as its "funding target"). The bill generally would require the shortfall to be amortized over a period of seven years. These changes would have the effect of reducing required contributions for some plans (due to the seven-year amortization period) and increasing required contributions for others (because of the higher funding target).

The bill also would limit the use of previously accumulated funding balances, which can be used to offset required contributions. Funding balances usually occur when a sponsor contributes more than the minimum required in a given year. Under current law, no matter

2. Because plans are estimated to be better funded on a current liability basis in the long run, collections of variable premiums under H.R. 2830 would fall starting in 2013.

3. Under certain circumstances, plans can be between 80 percent and 90 percent funded before being required to make deficit reduction contributions.

how underfunded a plan is, its sponsor may use funding balances to reduce or eliminate required contributions. In addition, the value of funding balances is not adjusted for actual gains or losses on the assets in which they are invested. Instead, these balances are increased each year by the same rate of return assumed for other assets held by the plan. H.R. 2830 would allow only plans that have a funding ratio of 80 percent or higher to use funding balances to offset required pension contributions. In addition, the bill would require plans to adjust the value of any balances for net gains or losses on the plan's assets. These changes to the use of funding balances would generally have the effect of increasing required contributions.

H.R. 2830 would also affect required contributions by: reducing the "smoothing" period used to calculate the actuarial value of assets and liabilities; updating the mortality table used to project future benefits; and adding a "loading factor" to the funding target of plans that are less than 60 percent funded.

In addition to changes in the funding rules, H.R. 2830 would also restrict some benefit payments for certain underfunded plans. Specifically, the bill would limit the ability of plans with a funding ratio of less than 80 percent to make lump-sum payments or amend the plan to increase benefits. It also would effectively freeze normal benefit increases in plans with funding ratios of less than 60 percent. In addition, the bill would prohibit plans from paying benefits for unpredictable contingent events, such as shutdown benefits to workers in facilities that are closed. If enacted, these policies would reduce liabilities, and therefore reduce benefit payments that the PBGC would be required to make for plans that are terminated in the future.

Accounting for all the policy changes contained in H.R. 2830, CBO estimates that the annual shortfall between assets and liabilities (on a present-value basis) among plans that the PBGC takes over during the 2006-2015 period would increase by several hundred million dollars. The larger shortfall would manifest itself in higher outlays for benefit payments by the PBGC, as those liabilities eventually come due, with a significant portion of those claims being paid well after 2015. The biggest reason for the increase in claims is the projected decrease in required contributions, at least during the first several years of the period, due to use of the corporate bond yield curve to discount current liabilities.[4] This effect would be offset to some degree, especially during the second half of the budget window, by the higher funding target and limits on benefit accruals. Overall, however, CBO estimates that the bill

4. The higher discount rate would be used to calculate plans' "current liability," which is used to determine funding requirements and any premium payments on underfunding. The bill would not, however, affect the discount rate used to calculate plans' "termination liability," which represents the present value of all future benefit payments owed by the PBGC upon termination of a plan.

would lead to an increase in underfunding among plans that would be terminated over the next decade, thus increasing outlays by the PBGC for pension benefits.

Transfers from PBGC's Trust Fund. The PBGC's assets are held in two separate funds: an on-budget revolving fund and a nonbudgetary trust fund.[5] The on-budget fund receives premium payments and makes outlays for benefit payments and administrative costs. The nonbudgetary trust fund holds assets from terminated plans until they are needed to help pay for benefits and other expenses. The PBGC makes periodic transfers from the nonbudgetary fund to the on-budget fund, where they are used to cover about half of all benefit payments and most of the PBGC's administrative costs. As with premiums, these transfers are offsetting collections to a mandatory account, and so are reflected in the budget as offsets to outlays.

In CBO's current-law projections, the combination of rising benefit payments and level premium income will cause the agency's on-budget fund to be completely exhausted in about 2013. No precedent exists for how the PBGC would proceed if its on-budget fund is depleted. However, CBO assumes that the agency would cover its expenses by increasing the percentage of benefits and other expenses being paid through transfers from its nonbudgetary trust fund, thus increasing offsetting collections above what they would have been if the fund had remained solvent.

CBO estimates the increases in premium receipts resulting from H.R. 2830 would cause the on-budget fund to remain solvent until partway through 2015. Because the bill would improve the finances of the on-budget fund, the PBGC would not need to increase the amounts transferred from the nonbudgetary fund in order to help cover benefit payments and other expenses during most of the 10-year projection period. By allowing the on-budget fund to remain solvent through the next decade, the bill would reduce those transfers by $5.7 billion over the 2013-2015 period. Because this change would reduce an offset to mandatory spending, it would result in a net increase in such spending.

Revenues

H.R. 2830 would alter existing tax law related to the treatment of pension plans. CBO and JCT estimate that, if enacted, those changes would increase receipts to the federal government during the 2006-2008 period, but decrease receipts after that. As a result, JCT estimates, enacting H.R. 2830 would increase revenues by about $1.1 billion over the 2006-2010 period and would reduce revenues by about $5.5 billion over the 2006-2015 period.

5. The PBGC has several different on-budget revolving funds and two nonbudgetary trust funds. For simplicity in the budgetary presentation, CBO combines the various on-budget and nonbudgetary funds into just two funds.

Most of the revenue effects would come from the altered funding rules for single-employer, defined-benefit pension plans. By affecting the amount of tax-deductible contributions firms make to their pension plans, these changes would increase revenues by $5.1 billion over the 2006-2008 period and then decrease revenues by $10.4 billion over the 2009-2015 period. The change from increases to decreases in revenues is due to the differing phase-in rates of the stricter funding rules and the new discount rates. In the short run, the higher discount rates would reduce contributions and increase revenues before the stricter funding rules come fully into effect. Over the longer term, however, the stricter funding rules would more than offset the effect of the higher discount rates, leading to overall revenue losses.

H.R. 2830 also would affect federal revenues by:

- *Changing funding rules for multiemployer defined-benefit plans*. Currently, payments to cover many costs of plans (for example, their unfunded past service liability) are spread over a period of years. The amortization periods range from 15 years to 40 years. H.R. 2830 would require plans' sponsors to amortize most costs over a 15-year period, thereby accelerating contributions and reducing corporate tax payments. JCT estimates this change would decrease revenues by less than $500,000 in 2006, by $56 million over the 2006-2010 period, and by $287 million over the 2006-2015 period.

- *Changing benefit accrual standards*. Under current law, an employee's accrual of benefits may not be stopped because of age. Under H.R. 2830, a plan would not violate this requirement if a participant's accrued benefit is as much or more than that of a similarly situated, but younger individual. In other words, age discrimination would not be present in such a case. As a result, firms might change the type of pension plans they offer and the amount of tax-deductible contributions to those plans. JCT estimates that this change would decrease revenues by $29 million over the 2006-2010 period and would increase revenues by $36 million over the 2006-2015 period.

LONG-TERM EFFECTS ON DIRECT SPENDING

Pursuant to section 407 of H. Con. Res. 95 (the Concurrent Resolution on the Budget, Fiscal Year 2006), CBO estimates that enacting H.R. 2830 would not cause an increase in direct spending greater than $5 billion in any of the 10-year periods between 2016 and 2055. During the four decades following 2015, reductions in outlays due to higher premium receipts would be larger than increases in outlays resulting from changes to transfers from the nonbudgetary fund and additional benefit payments.

ESTIMATED IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS

CBO and JCT have reviewed the provisions of H.R. 2830 and determined they contain no intergovernmental mandates as defined in UMRA. State, local, and tribal governments are exempt from the provisions of ERISA that the bill would amend, and the remaining provisions of the bill contain no intergovernmental mandates and would not affect the budgets of state, local, or tribal governments.

ESTIMATED IMPACT ON THE PRIVATE SECTOR

Some of the bill's changes to ERISA would impose mandates on sponsors and administrators of single-employer and multiemployer private-pension plans. CBO estimates that the direct cost to affected entities of the mandates in the bill, less the direct savings resulting from those mandates, would exceed the annual threshold specified in UMRA ($123 million in 2005, adjusted annually for inflation) in 2009 and thereafter. Most of that cost would result from the increase in premiums paid to the PBGC. JCT has determined that the tax provisions in the bill contain no private-sector mandates.

Premiums

The bill would increase the premiums that sponsors of single-employer plans are required to pay to the PBGC. CBO estimates that the additional premiums would total $2.0 billion over the 2006-2010 period.

Disclosures

Title II would require multiemployer plans to provide certain information to participants and beneficiaries when a plan enters into "endangered" or "critical" status. Title V would require single-employer plans to provide certain information to participants and beneficiaries when one or more plans sponsored by the employer are in "at risk" status. Both single-employer and multiemployer plans would be required to provide annual funding notices to all participants and beneficiaries within 90 days of the end of the plan-year. CBO estimates that the direct cost of those new requirements would be less than $30 million annually.

Funding Rules

Title I would make several changes to the funding rules in ERISA for single-employer, defined-benefit pension plans. Changes in the discount rate plans are required to use to value future liabilities would decrease the contributions sponsors would be required to make to their pension plans. Several other changes in funding rules would increase the amount of annual contributions that they would be required to make. Title II would change the funding rules in ERISA for multiemployer defined-benefit pension plans such that some sponsors would be required to increase the amount of annual contributions that they make to their plans.

The net effect of those changes would be to decrease the total amount of required pension contributions for sponsors of single-employer plans in the early years, and increase total required contributions in later years. CBO estimates that the changes in funding rules would increase required contributions for sponsors of multiemployer plans throughout the five-year period. The changes in funding rules in the bill would not change the liabilities that plans' sponsors have to current and future pension recipients, however. They would only affect the timing of the sponsors' contributions. Because we have little basis for estimating the costs or benefits to sponsors of changes in the amounts contributed to their pension plans (for example, the cost of borrowing additional funds or of using funds that would otherwise be available for other purposes), CBO cannot estimate the direct cost or savings from those provisions.

Lump-Sum Distributions

Title III would change the rules in ERISA used for determining the amounts of lump-sum distributions to plans' participants. A segmented interest rate based on corporate bond yields and an updated mortality table would be phased in for use in such calculations. Although the updated mortality table would cause a short-term increase in the amount of distributions, the substitution of the segmented interest rate for the 30-year Treasury rate would decrease that cost in most cases. Taken together, CBO estimates that these changes would likely have the net effect of reducing plans' costs.

PREVIOUS CBO ESTIMATE

This cost estimate supersedes and replaces the estimate for H.R. 2830 that CBO released on September 19, 2005. The previous estimate contained an error regarding the legislation's effect on direct spending. The earlier estimate indicated that the bill's effect on transfers from PBGC's nonbudgetary fund to its on-budget fund would increase direct spending by $7.4 billion over the 2013-2015 period; the correct figure is $5.7 billion. The previous estimate anticipated that the bill would enable the on-budget fund to remain solvent through at least 2015; we now estimate the fund would remain solvent through only part of 2015.

This correction does not affect CBO's estimate of the other changes in direct spending or revenues. Thus, whereas previously CBO estimated that enacting H.R. 2830 would increase federal budget deficits by $8.2 billion over the 2006-2015 period, we now estimate that the deficit increase would be $6.5 billion over that period.

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